FLANDERS CORP
Form 10-K
April 18, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2000

or

[ ] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____________ to ______________

Commission File Number 0-27958

FLANDERS CORPORATION
(Exact name of registrant as specified in its charter)

North Carolina	13-3368271
(State or other jurisdiction of incorporation or organization)	(IRS Employer ID Number)
2399 26th Avenue North, St. Petersburg, FL	33734
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (727) 822-4411

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of each class

Common Stock, $.001 per share par value

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of April 12, 2001, the aggregate market value of the voting stock held by non-affiliates of the registrant was $30,572,325.

As of April 12, 2001, the number of shares outstanding of the registrant's common stock was 26,379,633 shares.

FLANDERS CORPORATION
FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2000

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PART I

Item 1. Business

OVERVIEW

We design, manufacture and sell air filters and related products, and are focused on providing complete environmental control systems for end uses ranging from controlling contaminants in residences and commercial office buildings through specialized manufacturing environments for semiconductors and viruses.

Currently, we are one of the largest domestic manufacturers of air filters, which are utilized by many industries, including those associated with commercial and residential heating, ventilation and air conditioning systems (commonly known as "HVAC" systems), semiconductor manufacturing, ultra-pure materials, biotechnology, pharmaceuticals, synthetics, nuclear power and nuclear materials processing. We also design and manufacture much of our own production equipment to automate our processes in order to decrease labor costs associated with our standard products. We also produce glass-based air filter media for many of our products. Our customers include Abbott Laboratories, The Home Depot, Inc., Motorola, Inc., Merck & Co., Inc., Upjohn Co., Wal-Mart Stores, Inc., Westinghouse Electric Corp., and several large computer chip manufacturers.

The vast majority of our current revenues come from the sale of after-market replacement filters, since air filters are typically placed in equipment designed to last much longer than the filters.

GENERAL DEVELOPMENT OF BUSINESS

Flanders Corporation was incorporated on July 2, 1986 in the State of Nevada, and is currently domiciled in North Carolina.

INVESTMENT BANKING

On March 21, 2000, we announced that we had engaged the investment banking firm PaineWebber Incorporated to help us explore strategic alternatives, including the possible sale of the Company.

FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

This annual report, including all documents incorporated herein by reference, includes certain "forward-looking statements" within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, including, among others, those statements preceded by, following or including the words "believe," "expect," "anticipate" or similar expressions. These forward-looking statements are based largely on the current expectations of management and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. In addition to the other risks described in the "Factors That May Affect Future Results" discussion under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II of this annual report, important factors to consider in evaluating such forward-looking statements include risk of product demand, market acceptance, economic conditions, competitive products and pricing, difficulties in product development, commercialization and technology. In light of these risks and uncertainties, there can be no assurance that the events contemplated by the forward-looking statements contained in this annual report will, in fact, occur.

STRATEGY

We have embarked on a program to increase earnings, and hence shareholder value, by improving our operating efficiency. We are seeking to grow primarily through the introduction of qualitatively superior new products to our major marketplaces, primarily through existing customers.

INTRODUCE NEW PRODUCTS

In the last two years, we have focused our development efforts into products which address the actual technical requirements of maintaining clean air to promote health. Maintaining ultra-clean air in residential and commercial settings requires continuous and complete replacement of "used" air contaminated by contact with hair, skin, carpet, solvents, cigarette smoke and other common particle sources with air filtered through a combination of pre-filters, HEPA filtration, and odor removal. This typically requires high-velocity directed air flow for stand-alone units, necessary to prevent air from recirculating in only a small area, or upgraded and augmented blowers for central or zoned HVAC systems necessary to push air through more effective filters. Most currently available air filters for commercial, industrial and residential use, including those advertised as "high-MIRV rating" filters, are primarily useful for protecting motors, coils and other components from airborne grease condensation and other contaminants which reduce the life of the HVAC equipment, and have little or no effect on reducing airborne contamination which is harmful to humans.

Comprehensive Indoor Air Cleaners for Residences. During 2000, we completed the development of two lines of high-capacity indoor air cleaners intended for residential use: Airia Portable Room Air Cleaners are stand-alone units which deliver ultra-clean air to a specific area of a residence; and Airia Wholehouse Electronic Air Cleaners are in-duct units installed as an integral part of a home's forced air heating and cooling systems, which deliver ultra-clean air throughout an entire house. The stand-alone units, to be offered through retailers and wholesale distributors, offer several advantages over competing units including:

- high-speed blowers which reduce the problems experienced by competing models which recirculate already-clean air through a small volume of space, effectively providing clean air only to areas as small as two feet square;

- A complete selection of high-end air filtration technologies, including, depending on the model selected, HEPA filtration to remove microscopic particles, pre-filters to remove large particles and extend the life of the HEPA cartridges, carbon filtration to remove odors, and electrostatic filtration to filter smoke and microscopic particles without substantially obstructing air flow.

The in-duct units will be sold as home improvement projects through retailers, HVAC wholesalers and specialty distributors, and will deliver ultra-clean conditioned air to an entire residence through existing forced-air heating or cooling systems. Both product lines will require users to regularly purchase and install replacement filters.

Capitalize on Commercial and Industrial Products. During 2000, we established a complete line of air filtration products to be used in the automotive and aeronautics industries. We were able to adapt our bulk manufacturing processes to the high-capacity synthetic media required for this end use. These products have been certified to meet E.P.A. test method 319, a standard regarding filtration of particulates from paint booth applications. These products may now be used in a variety of regulated activities, including the removal of potential environmental contaminants from spray booth exhaust and the protection of end products from external contaminants. During 2000, we secured contracts with several aeronautics and automobile manufacturers which will begin shipping in significant volume during 2001.

Indoor Air Cleaners for Commercial Offices. We are adapting our residential air cleaner line to the needs of commercial offices, for use in individual rooms and local air control zones. These units will be sold through our current network of wholesale HVAC distributors and air filter sales and service providers. Marketing for these products will include adapted sales literature, technical seminars and electronic multimedia presentations. We believe these products will also serve as a "hook" for our indoor air quality and remediation services.

Offer Indoor Air Quality Diagnosis and Remediation Services. During 1999, as part of the acquisition of the Tidewater group of companies, we acquired a small engineering firm specializing in monitoring air quality using automated real-time data collection techniques over a period of months, diagnosing any potential indoor air quality problems and suggesting remediation programs. We believe we will be able to leverage this expertise into value-added sales to our existing industrial and commercial customers, and the filter sales and service companies which supply them, increasing our revenues by adding value-added consulting and monitoring services.

IMPROVE OPERATING EFFICIENCY

Enhance Manufacturing Efficiency Due to Restructuring. We have identified approximately 350 positions, or approximately thirteen percent of our labor force, which were not required for efficient operation of our plants, and have implemented a reduction in force to remove these positions. This reduction in force is expected to save approximately $8 million in direct and indirect labor costs in 2001.

Provide Positive and Negative Incentives to Return to Financial Model. All operating facilities and departments, including corporate headquarters, will be required to reduce wages by ten percent, either through additional reductions in force or through salary and wage reductions, including senior management wage reductions of ten percent, until we meet internally established budgets and financial goals, as determined by the Board of Directors, effective April 19, 2001.

Centralize Overhead Functions. During 2000, we consolidated all of the sales forces of our various subsidiaries into a single, consistent national sales team, eliminating overlapping territories, duplication of literature, centralizing travel coordination and adding focus to our sales efforts. During 2000, we consolidated benefit administration and risk management to reduce administrative staff and allow savings in workers' compensation and other insurance coverages associated with larger groups. We are continuing to centralize and eliminate duplication of efforts between subsidiaries in the following areas: purchasing, production planning, shipping coordination, accounting and personnel management.

Increase Prices to Problem Accounts. During 1999 and 2000, we received national contracts from major retailers which required our first exposure to new "point-of-sale" distribution requirements. The contracts had pricing predicated upon certain erroneous assumptions regarding the costs of these distribution methods, and these problems were exacerbated by increases in fuel and related shipping expenses. We are working with these accounts to achieve acceptable levels of profit, simplify their distribution requirements, or replace them with more profitable accounts.

Expand Mexican Manufacturing to Reduce Direct Labor Costs. We expect to have completed an expansion of our Tijuana, Mexico, plant, which will produce our standard spun-glass and pleated filters, in all grades, for sale in the western U.S., by the end of June 2001. We will be moving some of the production equipment from our plants in San Diego and Nevada to this expansion.

Vertical Integration. In December 1997, we acquired a small glass media manufacturing plant in Salt Lake City, Utah, which produced spun-glass media for our highest-volume products, flat panel filters, using traditional processes, supplying perhaps 5% of our demand for this material. This plant was also in the process of building a more efficient plant for producing the spun-glass media used in these filters. In 1998, we began to build the second generation of equipment for this purpose. By September 2000, we had completed and installed enough of this equipment to realize significant production. We plan to establish a duplicate plant in North Carolina to alleviate forecast shortages in this material. See ""Source and Availability of Raw Materials."

Strategic Acquisitions. We continue to search for opportunities to acquire new businesses, although our criteria for evaluating these businesses has moved toward acquiring regional distributors and resellers, and away from acquiring competing air filter manufacturers. We are looking for potential acquisitions with the following characteristics: (i) dominant positions in local or regional markets, (ii) a stable customer base distinct from our existing customers, and (iii) a history of consistent and healthy earnings. Acquiring resellers and distributors with these characteristics allows us to increase operating margins by removing at least one layer of "middlemen," and their compounding mark-ups and commissions from the sales and

distribution process, allowing us to charge higher prices while maintaining competitive pricing with end users. At the present time, we do not have any binding agreements with respect to future acquisitions.

Electronic Commerce. We believe there are significant cost savings and error reduction opportunities in allowing our customers to enter orders, examine specifications, receive confirmations, and check on the status of their orders, via the Internet. In September 1999, we began an initiative to analyze all other areas of our business for plans to implement savings by using the Internet to automate communications with current customers, potential customers, end users and investors. We believe there are opportunities for significant cost reductions in customer service, shipping errors, orders administration, customer pre-qualification, lead generation and documentation storage. We anticipate completion of the first iteration and implementation of this process in the year 2001, and plan to make the Internet a central part of our future strategy for growth and cost minimization. We do not anticipate significant direct retail sales from electronic commerce in the foreseeable future, because shipping bulky packages of inexpensive filters in less than truckload quantities is prohibitively expensive.

INCREASE MARKET SHARE

Use Facilities Located Throughout the United States to Increase Market Share. Through acquisition and the establishment of new plants, we have placed facilities within one day's over-the-road shipping of most major population centers in the United States. We believe this ability to regionalize production and distribution will improve our business in several ways: (i) Decrease cost of sales by reducing the average distance between our plants and our customers, and hence decrease the cost of outbound freight; (ii) increase responsiveness by decreasing the average time required to ship products to customers; and (iii) increase our share of national accounts' total business by having manufacturing facilities in closer proximity to customers' regional distribution centers. The ability to service all major population centers with regional manufacturing centers is critical for our business, allowing us to compete on price against less broadly based competitors without sacrificing margins, as well as the ability to respond more rapidly than most of our competition.

Continued Emphasis on Quality and Performance. A continued emphasis on product quality and on-time shipments has allowed us to capture market share serving several industries in recent years.

INDUSTRY BACKGROUND

The McIlvaine Company, a leading industry analyst, estimated that the worldwide air filtration market would be approximately $3.2 billion in 1999 and $3.4 billion in 2000, with the United States being the largest market for air filters because of the prevalence of forced air heating and cooling. McIlvaine also estimated the air filtration market would grow at an annual rate of 8% per year through 2003. They indicated that the driving forces behind growth in the air filtration market would be using higher-performance filters in commercial and residential spaces instead of current low-efficiency models, and the use of air filters in new applications. Management believes the forces driving the air filtration market are evolving, beginning in the past decade and continuing for the next several years, from preserving machinery and equipment to maintaining indoor air quality. In addition, we expect many high-growth technology industries to increase their reliance on air filters to remove microscopic and gaseous contaminants from sensitive manufacturing processes associated with semiconductor manufacturing, pharmaceutical production, ultra-pure materials manufacturing and biotechnology. Companies are devoting resources to air filtration products to enhance process efficiency and employee productivity.

Air filters are used in many different applications, including the following:

- Commercial and Residential HVAC Systems. Replacement filters are an essential requirement for the efficient operation of commercial and residential HVAC systems.

- Residential air cleaners. Stand-alone air cleaners which produce ultra-clean air in a defined area are also gaining in popularity among allergy sufferers and asthmatics, although follow-up sales of replacement filtration cartridges have been limited.

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- General Industrial. Air filters are used in standard industrial settings to provide cleaner work environments; for example, auto makers use air filtration systems to remove "oil mist" contaminants from the air in their plants, and industrial paint booth users utilize air filtration to remove paint particles from the air.

- Semiconductors. HEPA and carbon filters are necessary to meet the increasingly stringent manufacturing environment requirements of semiconductor manufacturers, where microscopic airborne contaminants can ruin microchips during production, having a large impact on manufacturing yield and profitability. Carbon filters are also being increasingly used to filter gaseous contaminants from semiconductor manufacturing areas.

- Pharmaceuticals. Pharmaceutical companies are increasingly using cleanrooms to prevent cross-contamination between different products and different lots of the same product being manufactured at the same facility. The increasing use of cultured microbes for drug production is also expected to increase demand for high-end containment environments.

- Biotechnology. Containment systems for the manipulation of viruses and bacteria using genetic engineering techniques are critical to the biotechnology industry.

- Nuclear Power and Materials Processing. Filtration systems are necessary to radioactive containment procedures for all nuclear facilities.

RECENT TRENDS

Recent trends in the air filter industry, as well as changes in laws and governmental regulations during the past five years, all encourage an increased awareness of the benefits of the use of air filtration products. Some of these trends and changes are:

Indoor Air Quality and Health. We believe there is an increase in public concern regarding the effects of Indoor Air Quality on employee productivity and health, as well as an increase in interest in standards for detecting and solving IAQ problems. For example, the American Society of Heating Refrigeration and Air-Conditioning Engineers (ASHRAE) has recently established certain minimum standards for ventilation and indoor air quality for commercial and industrial settings. The World Health Organization has recently been studying the effects of air quality on human health, including widely publicized epidemiological studies indicating that airborne contaminants kill more people than automobile accidents.

Lack of Legitimate Competing Products. We believe there is an increase in public and regulatory frustration with spurious and misleading claims made by other manufacturers in the air filtration industry. This trend is evidenced by recent rulings by the Federal Trade Commission disallowing claims of "cleaning the air in an entire room" made by several manufacturers of "area HEPA filtration systems" as well as medical benefits claimed by manufacturers of "passive electrostatic" washable synthetic filters.

Hazardous Working Environments. Several studies recognize that air quality in working facilities has an impact upon human health. OSHA regulations, in particular, have made IAQ a consideration in a wide variety of industries, ranging from those industries using spray-paint booths to those using automobile assembly lines.

Sick Building Syndrome. Sick Building Syndrome, which is characterized by lethargy, frequent headaches, eye irritation and fatigue, has recently been shown to be a valid concern, and is a major design consideration in new and renovated commercial and industrial buildings. The identification of "sick" buildings, and solutions for mitigation, involve complex issues which need to be examined on a case-by-case basis by qualified engineers; solutions typically include improving the HVAC and filtration systems of the "sick" buildings.

Hazardous Emission Regulation and Resultant Liability. Electrical utilities became subject to emissions regulations under Title 4 of the Clean Air Act. In addition, OSHA's Hazardous Communication Standard, the Toxic Release Inventory and community "right to know" regulations regarding liability for claims made by employees or neighboring communities have made many industries, in particular the chemical and semiconductor industries, more aware of clean air regulations. As a result, these industries have taken voluntary steps, including the utilization of air filtration systems, to bring emissions of potentially hazardous substances into line with regulatory standards.

MARKETING

During 2000, we restructured and centralized our sales and marketing structure and produced a group of unified air filtration products catalogs, which we believe allows us to focus our marketing efforts more precisely, and ensures consistency of presentation and pricing across all customers. Previously, each subsidiary had its own sales and marketing infrastructure, its own product lines, and its own marketing strategy, which contributed to waste and inefficiency, and more importantly, market confusion. Our new marketing efforts are targeted to the needs of individual customers and groups of customers. Each customer or group of customers is targeted with some combination of the following: mass marketing allowances and incentive programs for retailers, educational point of purchase materials and enhanced signage for consumers, enhanced and unified technical literature for HVAC equipment manufacturers and wholesalers, targeted technical presentations for specialized manufacturing environments, and industry-specific technical seminars for filter sales and service organizations.

Much of our marketing effort consists of personal visits to customers and distributors through an extensive tiered network of contract salespeople. Periodic visits are enhanced by mass mailings announcing new products, participation in trade shows for exposure and lead generation, technical articles and advertisements in trade periodicals, and a newly redesigned catalog containing all Flanders products. During 2000, we restructured and unified all of our product offerings, so that each subsidiary no longer generates its own marketing literature. We also re-wrote the bulk of our catalog and promotional materials to include all product lines in a consistent and easy-to-access format which can be used by all of our customers.

Besides developing new sales leads and contacts, we are also focused on increasing the effectiveness of our existing distributors and contract salesmen, by allowing them to offer our products as a complete "single-source" for air filtration products. We believe this will allow them to increase their sales for the following reasons:

Technical Support and Education. We are developing a range of technical reference and training materials, along with full-day seminars on various aspects of air quality. These seminars will increase the effectiveness of our distribution network, encouraging "upselling" and continuing the process of encouraging true awareness of indoor air quality and the methods of truly dealing with the issues involved.

Dependability and Responsiveness. Our ability to express-ship via standard ground freight to any major population center within one day is a key competitive advantage. We also believe that our expansion program and general production capacity also allow us to handle relatively large orders with shorter lead times than any of our competitors.

Product Quality. We are known as a manufacturer of high performance air filtration products. We currently offer filters of 99.999997% on particles 0.1 microns or larger, which we believe is the highest efficiency rating available anywhere. We have also been recognized for consistency and quality of our products by several third-party rating organizations.

Name Recognition. We believe that each of our product lines has high name recognition in its target markets. Our representatives and distributors have indicated that they believe their sales will increase with additional products associated with Flanders.

Single-Source Supplier. We provide a full line of air filtration products. The ability to work with a single source for filters will enable representatives to operate more efficiently, only needing to be trained on one filtration system, maintain contacts with a single organization and order from a central source.

Product Promotion and Innovation. We plan to continue to introduce new applications we are developing for filtration products. Representatives and distributors will be able to take advantage of the additional name recognition and public knowledge associated with the marketing of the new products. We believe these representatives will see this as a competitive advantage to selling our products.

PRODUCTS

We design, manufacture and market a broad range of air filters and related products, including:

- Residential heating and air conditioning filters, typically sold through retailers under the Flanders~Precisionaire brand name.

- Residential air cleaners, developed in 2000, which offer a range of different filtration types ranging from single-room HEPA units which clean the air in a room to near-cleanroom levels to in-duct electrostatic precipitators which remove large quantities of airborne contaminants from entire residences without negatively impacting the efficiency of HVAC systems.

- Industrial mid-range specialty filters which fall under specifications which are categorized by efficiency ratings established by the American Society of Heating, Refrigeration and Air Conditioning Engineers (ASHRAE), used in a wide variety of industries, including paint facilities, automobile factories, chemical treatment plants, mushroom farms, coal mines, oil refineries and power plants

- Commercial and industrial filters for use in office and general manufacturing environments, typically sold through wholesalers and distributors

- High Efficiency Particulate Air (HEPA) filters (at least 99.97% efficient) in various grades, for use in semiconductor facilities, nuclear containment vessels, disease containment facilities, and other critical applications

- Absolute Isolation Barriers which are customized stand-alone units, typically manufactured of stainless steel, used in various industries which require absolute control over contaminants, atmospheric composition and containment

- Carbon filters, both in bonded panels and activated charcoal beds, used to remove gaseous contaminants, odors and toxic chemical vapors in various commercial and industrial applications

- Specialized air filter housings, for use in multi-stage filtration applications

- Other related products, including tubing insulation, ductwork and equipment cleaning chemicals, custom air handlers and specialized filter housings.

MANUFACTURING

We manufacture air filters, housings, Absolute Isolation Barriers and related equipment at several facilities in the United States, which range in size from 18,000 square feet to approximately 400,000 square feet. The major plants are:

- Ten separate manufacturing facilities located in Bartow, Florida, Terrell, Texas, Salt Lake City, Utah, Henderson, Nevada, Momence, Illinois, Smithfield, North Carolina, San Diego, California, Tijuana, Mexico and Auburn, Pennsylvania, produce a broad range of commercial, residential and industrial filters.

- One facility in Washington, North Carolina, produces high-end HEPA products for cleanrooms.

- One facility in Bath, North Carolina, manufactures HEGA filters, high-end containment environments, housings, custom filter assemblies and other custom filtration products and systems which require extensive custom design, production and lot tracking, including products used in the production and containment of potentially dangerous biologically engineered microorganisms.

- One facility in Stafford, Texas, produces mid-range custom filter housings and air handlers.

In addition, we design, manufacture and assemble the majority of our automated production equipment.

Our manufacturing operations are subject to periodic inspection by regulatory authorities. Because of the nature of some of our products, these agencies include, in some cases, the Department of Energy, the Food and Drug Administration and other agencies responsible for overseeing sensitive technologies. One of the considerations in deciding which types of products each facility will manufacture is the segregation of highly-regulated products to a minimal number of facilities to reduce the overhead associated with regulatory monitoring and compliance.

Each of our manufacturing facilities utilizes testing and design strategies appropriate to the products manufactured. These range from standard statistical process quality controls for residential replacement filters to individual testing and certification with patented proprietary particle scanning technologies for each laminar-grade HEPA filter. We believe that our ability to comprehensively test and certify HEPA filters is a competitive advantage.

SOURCE AND AVAILABILITY OF RAW MATERIALS

Our principal raw materials are cardboard, fiberglass fibers, extruded glass, sheet metal, extruded aluminum, adhesives, resins and wood. All of these raw materials, except fiberglass fibers, are readily available in sufficient quantities from many suppliers. We are currently facing a potential shortage of Madiglioni fiberglass, the base material for our spun-glass filters, which are our largest individual product line in terms of unit sales. Because of this shortage, we may have to fill any demand in excess of production capacity with alternative products, primarily pleated filters.

COMPETITION

The air-filtration market is fragmented and highly competitive. There are many companies which compete in our market areas. We believe that the principal competitive factors in the air filtration business include product performance, name recognition, price, product knowledge, reputation, customized design, timely delivery and product maintenance. We believe that we compete favorably in all of these categories. Competitors include successful companies with resources, assets, financial strength and market share which may be greater than ours. Major competitors include American Air Filter International, Farr Company, HEPA Corporation, Purolator Products Air Filtration Company, Donaldson Company, Inc. and Clark Corporation.

PATENTS, TRADEMARKS AND LICENSES

We currently hold 19 patents relating to filtration technology, including patents relating to HEPA filters and fabrication methods, filter leak testing methods, laminar flow cleanrooms, components of isolation barriers, and the baking soda impregnation method used in the manufacture of Arm & Hammer Pleated Filters.

We have obtained and own the following federal trademark registrations: PRECISIONAIRE(R), EZ FLOW(R), SMILIE(R), AIRVELOPE(R), CHANNEL-CEIL(R), CHANNEL-HOOD(R), PUREFORM(R), ECONO-CELL(R), GAS-PAK(R), PUREFRAME(R), DIMPLE PLEAT(R), BLU-JEL(R), VLSI(R), CHANNEL-SEAL-ADAPTER(R), SUPERFLOW(R), FLANDERS(R), CHANNEL-WALL(R), SUPERSEAL(R), AIRPURE(R) and PURESEAL(R). The Company also has applied for federal trademark protection for the following marks: FLANDERS ABSOLUTE ISOLATION(TM), FLANDERS/CSC(TM), TECH-SORB(TM) and FUTUREFLO(TM). Although management believes that the patents and trademarks associated with our various product lines and subsidiaries are valuable, we do not consider any of them to be essential to our business.

We currently license some of our products to foreign specialty HVAC and ASHRAE filter manufacturers who produce products under their own name and with their own identifying labels.

CUSTOMERS

We are not dependent upon any single customer. One customer, Wal-Mart Stores, Inc., accounted for 9%, 10%, and 10% of net sales during 2000, 1999 and 1998, respectively. Home Depot, Inc., accounted for 13%, 12% and 10% of net sales during 2000, 1999 and 1998, respectively. No other single customer accounted for

10% or more of net sales. Other significant customers include Abbott Laboratories, Motorola, Inc., Intel Corporation, Merck & Co., Inc., Upjohn Co., Westinghouse Electric Corp., and several large computer chip manufacturers.

BACKLOG

We had approximately $18,400,000 in firm backlog on December 31, 2000, compared to $12,700,000 on December 31, 1999. Firm backlog includes orders received and not begun and the unfinished and unbilled portion of contracts in progress. Orders are typically not cancelable without penalty, except for certain stable filter supply contracts to nuclear facilities operated by the United States government. Backlog varies from week to week, based on the timing and mix of orders received. All backlog at December 31, 2000, is expected to be shipped by the end of the second quarter of 2001.

EMPLOYEES

The Company employed 2,719 full-time employees on December 31, 2000; 2,355 in manufacturing, 20 in development and technical staff, 61 in sales and marketing, and the remaining 283 in support staff and administration. The Company believes that its relationship with its employees is satisfactory. Manufacturers' representatives are not employees of the Company.

RESEARCH AND DEVELOPMENT

Our research and development is focused in the following areas:

Automated equipment design, to increase the efficiency and profitability of production lines used for mass production of off-the-shelf filters.

Alternative filtration media types, including evaluation of new synthetic media products, which might either increase efficiency or decrease media costs; the Company's Arm & Hammer Pleated Filters are an application of this type of research.

Improved media production techniques, particularly at Precisionaire's spun fiberglass production facility in Salt Lake City, Utah, and FFI's HEPA paper mill in Washington, North Carolina; during the past ten years, the Company has increased the efficiency of its filters through advances in media formulation and production techniques from 99.97% to 99.999997%.

Application development, where new methods and products are developed from existing technologies; the Company's in-house air cleaners are an application of this type of research.

Research and development costs for 2000, 1999, and 1998 were approximately $1,174,000, $763,000 and $2,250,000, respectively. Research and development costs were expensed and included in general and administration expenses during the period incurred.

GOVERNMENT REGULATION

Our operations are subject to certain federal, state and local requirements relating to environmental, waste management, health and safety regulations. We attempt to operate our business in compliance with all applicable government, environmental, waste management, health and safety regulations and we believe that our products meet standards from applicable government agencies. There can be no assurance that future regulations will not require us to modify our products to meet revised safety or other requirements.

SEASONALITY

Historically, our business has been seasonal, with a substantial percentage of sales occurring during the second and third quarters of each year. In addition, demand for our general commercial and industrial products appears to be highly influenced by the weather, with higher sales generally associated with extremes of either hot or cold weather, and lower sales generally associated with temperate weather. Because of these seasonal and weather-related demand fluctuations, quarter-to-quarter performance may not be a good predictor of future results.

EXPORT SALES

We sell products for and to end users outside of the United States through domestic specialty cleanroom contractors. These sales are counted as domestic sales. We also sell products through foreign distributors, primarily in Europe, and through Flanders International, Ltd., a wholly-owned subsidiary located in Singapore which sells to customers in the Far East. Sales through foreign distributors and Flanders International amounted to less than 5% of net sales for each of the last three fiscal years. Assets held outside the United States are negligible.

Item 2. Properties

The following table lists our principal facilities. Management believes that these properties are adequate for its current operational needs, but we may at some point relocate, reorganize or consolidate various facilities for reasons of operating efficiencies, or may open new plants to take advantage of perceived new economic opportunities.

Principal Facility	Location	Approximate Floor Space (sq. ft.)	Monthly Expense	Lease/Type
Manufacturing and office facility	Washington, North Carolina	251,000	$ 13,775	Owned(1)
Manufacturing, service and office facility	Bath, North Carolina	44,282	N/A	Owned
Manufacturing plant	Bartow, Florida	175,000	29,121	Owned(1)
Manufacturing plant	Terrell, Texas	168,000	29,858	Owned(1)
Manufacturing plant	Auburn, Pennsylvania	91,000	7,097	Owned(1)

Office space and headquarters	St. Petersburg, Florida	18,000	N/A	Owned
Office space and Warehouse	Richmond, Virginia	10,000	2,200	Leased
Office space and Warehouse	Virginia Beach, Virginia	25,000	6,850	Leased
Warehouse and distribution center	Henderson, Nevada	100,000	26,000	Leased
Manufacturing plant	Momence, Illinois	210,000	44,062	Owned(1)(2)
Sales office and warehouse	Singapore	10,000	3,350	Leased
Manufacturing and warehouse	Smithfield, North Carolina	138,000	27,520	Leased(4)
Manufacturing plant	Smithfield, North Carolina	399,090	N/A(3)	Owned
Manufacturing and office facility	Stafford, Texas	18,000	N/A	Owned
Manufacturing plant	Salt Lake City, Utah	170,000	N/A	Owned
Plant and office facility	San Diego, California	97,000	37,697	Leased
Manufacturing plant	Tijuana, Mexico	118,000	42,800	Leased

1 This property is encumbered by a mortgage.

2 This mortgage is paid quarterly rather than monthly; the quarterly payments are $132,187.

3 This property is used as security for an Industrial Revenue Bond with face value of $4,500,000. Monthly payments are for interest only on the bond, and vary from month to month based on the interest rate during the period. At December 31, 2000, the interest rate on the bond was 5.14%.

4 This building is owned by a partnership which includes, as minority partners, two of the Company's officers and directors.

Item 3. Legal Proceedings

During 2000, we settled our lawsuit with Intel Corporation (The Superior Court of the State of Arizona, in and for the County of Mariposa, Case No. CV 98-19817), wherein Intel asserted that filters supplied to Intel were defective because of a change in the formulation of urethane used as a sealant in the filters. As part of the settlement, the Company agreed to pay Intel $1.5 million accept the return of the filters as payment for its account receivable from Intel, and provide Intel with HEPA filters for future work.

In a related matter (U.S. District Court for the Eastern District of North Carolina, Case No. 4-99-CV-93-H(3)), the Company has sued Conap, the supplier of the urethane sealant, for supplying a sealant which did not meet specifications for the project. The amount and probability of any settlement or award is unknown at this time.

We are involved in a dispute with a benefit plan administrator (U.S. District Court, Middle District of Florida, Tampa Division, Case No. CIV 1971-T-17-F, Liberty Mutual v. Flanders Corporation et al). Liberty Mutual was the Workers' Compensation administrator and stop-loss insurer for some of the Company's subsidiaries. They have alleged that they are owed insurance premiums and administrative fees. We have counter-sued, claiming that Liberty Mutual was negligent in its duties as administrator of our claims, that it made payments on our behalf which were specifically disallowed, that they refused to follow instructions given to them by us, that they failed to meet minimal acceptable standards for administering claims, and that such failures constituted a material dereliction of their responsibilities as administrator, as well as other claims related to malfeasance and negligence. The amount and probability of any settlement or award related to this litigation is unknown at this time. Among the issues being considered is the matter of currently unresolved workers' compensation claims whose estimate of potential loss may change as a result of this litigation. While management believes it has reserved an adequate amount for settlement of these claims, there is no guarantee that the Company's actual liability will not exceed its current estimate. Accordingly, these matters, if resolved in a manner different from management's estimate, could have a material effect on the operating results or cash flows in any one future accounting period.

Additionally, from time to time, we are a party to various legal proceedings incidental to our business. None of these proceedings are material to our business, operations or financial condition.

In the opinion of the Company, although the outcome of any legal proceeding cannot be predicted with certainty, the ultimate liability of the Company in connection with its legal proceedings will not have a material adverse effect on the Company's financial position, but could be material to the results of operations in any one future accounting period.

Item 4. Submission of Matters to a Vote of Security Holders

We held our annual meeting of shareholders on December 18, 2000. During the meeting, holders of 14,933,405 shares, representing approximately 57% of 26,379,633 shares outstanding on the record date, attended either in person or by proxy. Holders of 14,911,805 shares (approximately 99.9% of shares present) voted to elect as members of the Board of Directors each of Robert R. Amerson, Steven K. Clark, J. Russell Fleming and Linwood Allen Hahn; holders of 21,600 shares chose to vote against the election of each of the above-named directors. As a result, Messrs. Amerson, Clark, Fleming and Hahn were elected for an additional one-year term as directors.

Holders of 14,933,405 shares (approximately 99.9% of shares present) voted to ratify the firm of Grant Thornton LLP as the Company's independent auditors for the fiscal year ended December 31, 2000; holders of 21,600 shares voted against the ratification. As a result, Grant Thornton's appointment as the Company's auditors for 2000 was ratified.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

PRICE RANGE OF COMMON STOCK

The Company's common stock is listed on the Nasdaq National Market System under the symbol "FLDR." The following table sets forth, for the periods indicated, the high and low closing prices of the Company's common stock as reported by the Nasdaq National Market System. Such quotations do not include retail mark-ups, mark-downs, or other fees or commissions.

	High	Low
Fiscal 2000		
Fourth Quarter ended December 31, 2000	$ 2 19/32	$ 1 3/8
Third Quarter ended September 30, 2000	3 11/16	1 5/8
Second Quarter ended June 30, 2000	4 1/8	1 5/16
First Quarter ended March 31, 2000	4 1/8	2 9/16
Fiscal 1999		
Fourth Quarter ended December 31, 1999	$ 3 1/8	$ 2 1/4
Third Quarter ended September 30, 1999	3 3/8	2 3/8
Second Quarter ended June 30, 1999	3 13/16	2 1/2
First Quarter ended March 31, 1999	5 1/8	2 9/16

APPROXIMATE NUMBER OF EQUITY SECURITYHOLDERS

On April 12, 2001, Flanders' common stock closed at $1.77. As of April 12, 2001, there were approximately 350 holders of record of the Company's common stock. The Company estimates there are approximately 2,500 beneficial owners of the Company's common stock.

DIVIDENDS

We have not declared or paid cash dividends on our common stock. Currently, we intend to retain any future earnings to finance the growth and development of the business, therefore we do not anticipate paying cash dividends in the foreseeable future. In the future, the Board of Directors may decide to change this policy, based upon its evaluation of our earnings, financial position, capital requirements and any factors the Board of Directors may consider to be relevant. Under the terms of our revolving credit line we cannot pay dividends without the prior written consent of the bank. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" and "Notes to Consolidated Financial Statements - Note H."

SALES OF UNREGISTERED SECURITIES

The Company did not sell any unregistered common shares or other unregistered securities during 1998, 1999 and 2000.

Item 6. Selected Financial Data

The following financial data is an integral part of, and should be read in conjunction with, the "Consolidated Financial Statements" and notes thereto. Information concerning significant trends in the financial condition and results of operations is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

SELECTED HISTORICAL OPERATIONS DATA (In thousands, except per share data)

	Year Ended December 31,				
	2000	1999	1998	1997	
Net sales	$ 194,072	$ 171,392	$ 154,765	$ 131,899	$
Gross profit	36,917	43,975	37,660	32,880	
Operating expenses	40,733	33,802	28,108	23,510	
Operating income (loss) from continuing operations	(3,816)	10,172	9,551	9,370	
Earnings (loss) from continuing operations before income taxes	(6,940)	10,174	10,991	9,850	
Provision (benefit) for income taxes	(2,443)	4,671	4,450	3,751	
Earnings (loss) from continuing operations	(4,497)	5,503	6,541	6,098	
Loss from discontinued operations	(2,702)	(2,686)	(1,253)	(259)	
Net earnings (loss)	$ (7,199)	$ 2,817	$ 5,289	$ 5,839	$
Earnings (loss) per share from continuing operations					
Basic	$ (0.18)	$ 0.22	$ 0.26	$ 0.33	$
Diluted	$ (0.18)	$ 0.21	$ 0.24	$ 0.28	$
Earnings (loss) per share					
Basic	$ (0.28)	$ 0.11	$ 0.21	$ 0.32	$
Diluted	$ (0.28)	$ 0.11	$ 0.20	$ 0.27	$
Weighted average common shares outstanding					
Basic	25,298	25,344	25,134	18,509	
Diluted	25,298	26,525	27,107	22,477	

SELECTED HISTORICAL BALANCE SHEET DATA (In thousands)

	December 31,				
	2000	1999	1998	1997	
Working capital	$ 13,644	$ 45,421	$ 47,972	$ 55,179	$
Total assets	180,222	165,642	167,780	145,881	
Long-term obligations(1)	49,370	32,328	31,406	14,771	
Total shareholders' equity	98,151	107,817	109,603	106,207	

1 Long-term obligations include long-term notes payable, long-term debt, including current maturities, convertible debt, and committed capital.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with "Item 6 - Selected Consolidated Financial Data" and "Consolidated Financial Statements," all included elsewhere herein. The information set forth in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements that involve risks and uncertainties. Many factors, including but not limited to those discussed below under "Factors That May Affect Future Results" could cause actual results to differ materially from those contained in these forward-looking statements.

OVERVIEW

Flanders is a full-range air filtration product company engaged in designing, manufacturing and marketing high performance, mid-range and standard-grade air filtration products and certain related products and services. Our focus has evolved from expansion through acquisition to increasing the quality and efficiency of our high-volume replacement filtration products, and using these benefits to compete more effectively in the marketplace. We also design and manufacture much of our own production equipment and also produce glass-based media for many of our air filtration products. From 1996 to 1999, we experienced significant growth from the acquisition of other air filtration related companies. As a result, historical results of operations for the periods presented should be evaluated specifically in the context of these acquisitions. Historical results of operations do not reflect any future operating efficiencies and improvements from integrating and consolidating the acquired businesses into our operations. There can be no guarantee that we will be able to achieve these objectives and gains in efficiency.

RESULTS OF OPERATIONS

2000 Compared to 1999

The following table summarizes the Company's results of operations as a percentage of net sales for 2000 and 1999.

	2000		1999	
Net sales	$ 194,072	100.0%	$ 171,392	100.0%
Gross profit	36,917	19.0	43,975	25.7
Operating expenses	40,733	21.0	33,802	19.7
Operating income (loss) from continuing operations	(3,816)	(2.0)	10,172	5.9
Earnings (loss) from continuing operations before income taxes	(6,940)	(3.6)	10,174	5.9
Provision (benefit) for income taxes	(2,443)	(1.3)	4,671	2.7
Earnings (loss) from continuing operations	(4,497)	(2.3)	5,503	3.2
Loss from discontinued operations	(2,702)	(1.4)	(2,686)	(1.6)
Net earnings (loss)	$ (7,199)	(3.7)	$ 2,817	1.6

Net Sales: Net sales for 2000 increased by $22,680,000 or 13.2%, to $194,072,000, from $171,392,000 for 1999. The increase in net sales was due to the Company's success in capturing additional market share, which was achieved mainly through (i) attracting work from new customers through offering superior pricing and service programs; (ii) securing additional business from existing customers in expanded geographical regions; and (iii) the development and placement of new lines of filtration products with new customers for end users in new industries.

Other Charges and Special Items: During the last half of 2000, we formalized our plan to consolidate our west coast operations, and recorded other charges and special items totaling approximately $10,600,000 in connection with settling our outstanding litigation with Intel, consolidating operations, combining organizations, plant start-up expenses and for other nonrecurring items arising during the period. These expenses were booked as approximately $7,900,000 in cost of goods sold, $1,200,000 in operating

expenses and $1,500,000 in other expenses. Amounts booked for settlement of the Intel litigation included repurchasing inventory at a loss and cash payments - see "Litigation." Other one-time charges included costs for inventory adjustments, write-offs, plant start-up expenses, duplicate assets and other miscellaneous items. Without these one time charges and special items, earnings from continuing operations would have been approximately $2,600,000, or $0.10 per share.

Gross Profit. Gross profit for 2000 decreased $7,058,000, or 16.1%, to $36,917,000, which made up 19.0% of net sales, from $43,975,000 for 1999, which made up 25.7% of net sales. Excluding the one-time charges noted above, gross profit for 2000 would have increased by $842,000, or 1.9%, to $44,817,000, which represented 23.1% of net sales, compared to $43,975,000, which represented 25.7% of net sales for 1999. The decrease in gross profit excluding one-time charges percentage was principally attributable to:

- Delays in implementing our price increases associated with delays in the production of marketing materials and associated reorganized and consolidated marketing efforts. Anticipated benefits from this reorganization, the first stage of which was completed in mid-September, were not completed in time to have a material beneficial impact on our 2000 results.

- An increase in the percentage of our labor force employed through temporary services compared to 1999, caused by the continued tightness in the labor pool of qualified seasonal workers, which increased average labor costs per hour during the period and resulted in a net increase in comparable expenses of approximately $700,000.

- Price concessions made to secure new contracts with distributors for mid-range industrial end-users led to a decrease in average selling price to industrial distributors of approximately 2%.

- Expanded facilities in Salt Lake City, Utah and Tijuana, Mexico, which were brought partially online during 2000, experienced additional expenses associated with completing expansions, reorganizing production schedules, hiring and training additional laborers, and other inefficiencies typical of reorganized and expanded manufacturing operations.

- Fuel surcharges for inbound shipments of raw materials, which were attributable to a general increase in domestic diesel fuel costs caused by escalating political instability in the Middle East as well as OPEC supply constraints.

- During 1999 and 2000, we received national contracts from major retailers which required our first exposure to new "point-of-sale" distribution requirements. The contracts had pricing predicated upon certain erroneous assumptions regarding the costs of these distribution methods, and these problems were exacerbated by increases in fuel and related shipping expenses.

- Labor overruns and redundant personnel. See "Outlook" below.

Operating Expenses. Operating expenses for 2000 increased $6,931,000, or 20.5%, to $40,733,000, compared to $33,802,000 in 1999. Excluding one-time charges, operating expenses for 2000 would have increased $5,731,000, or 17.0%, to $39,533,000, which represented 20.4% of net sales, from $33,802,000, which represented 19.7% of net sales in 1999.

The increase in operating expenses excluding one-time charges was principally attributable to:

- Fuel surcharges on outbound shipments of finished goods to customers and other shipping cost increases primarily attributable to a sharp increase in diesel fuel costs amounted to approximately $2,800,000.

- A reevaluation of accounts receivable reserves due to economic downturn and an increase in the number of potentially bad receivables caused bad debt expense in 2000 to be approximately $1,450,000 higher in 2000 than in 1999, an increase of approximately 3800%.

- Other increases in operating expenses were held to 4.4%, with increases in sales commissions, outbound freight and other expenses directly related to sales volume balanced by reductions in redundant administrative staff, consolidation of positions between subsidiaries and other savings from our ongoing consolidation and cost reduction program.

Nonoperating income (expense) from continuing operations: Net nonoperating income (expense) from continuing operations decreased approximately $3,125,000, to an expense of approximately $3,124,000 for 2000, from income of $1,000 in 1999. Excluding the one-time charge for the settlement of our outstanding litigation with Intel of $1,500,000, nonoperating income (expense) from continuing operations decreased approximately $1,625,000, which consisted primarily of an increase in interest expense of $1,537,000 caused by higher average balances on the Company's credit facilities and a higher average interest rate on the Company's lines of credit, which have variable rates linked to standard interest rate indices.

Discontinued Operations: In December 1999, the Company adopted a formal plan to close Airseal West, a wholly owned subsidiary, and sell its various assets and product lines to unrelated third parties. The closure was completed in the first quarter of 2001, although various assets remain held for sale. The assets to be sold consist primarily of non-filtration assets consisting of inventories, manufacturing equipment, designs and intellectual properties. As there are no firm purchase commitments in place regarding the sale of these assets, the remaining net assets of Airseal West have been written down to $0. The estimated net loss of the discontinued operations of approximately $2,702,000 and $2,686,000 in 2000 and 1999, respectively, consists of net losses from discontinued operations of $1,820,000 and $1,793,000, respectively, approximately $893,000 of estimated losses on the disposal of assets which were accrued in 1999, and an additional $883,000 of estimated losses on the disposal of assets accrued in 2000.

Provision for Taxes: Our blended state and federal tax rate, excluding the effect of nondeductible expenses consisting primarily of amortization of goodwill of approximately $900,000 per year and one-time adjustments, was approximately 40.0% for both 2000 and 1999.

Earnings (loss) from Continuing Operations: Earnings (loss) from continuing operations for 2000 decreased $10,000,000, or 182%, to a loss of $4,497,000, or ($0.18) per share, from $5,503,000, or $0.22 per share basic ($0.21 diluted) for 1999. The decrease in earnings is primarily attributable to one-time charges and decreases in gross profit percentage discussed above.

1999 Compared to 1998

The following table summarizes the Company's results of operations as a percentage of net sales for 1999 and 1998.

	1999		1998	
Net sales	$ 171,392	100.0%	$ 154,765	100.0%
Gross profit	43,975	25.7	37,660	24.3
Operating expenses	33,802	19.7	28,108	18.2
Operating income from continuing operations	10,172	5.9	9,551	6.2
Earnings from continuing operations before income taxes	10,174	5.9	10,991	7.1
Provision for income taxes	4,671	2.7	4,450	2.9
Earnings from continuing operations	5,503	3.2	6,541	4.2

Loss from discontinued operations	(2,686)	(1.6)	(1,253)	(0.8)
Net earnings	$ 2,817	1.6	$ 5,289	3.4

Net Sales: Net sales for 1999 increased by $16,627,000 or 10.7%, to $171,392,000, from $154,765,000 for 1998. The increase in net sales was due to: (i) the acquisitions of Eco-Air and the Tidewater group, which contributed approximately $15,334,000 of net sales; and (ii) the Company's success in attracting work and expanding its original core business, which grew by approximately 1% between 1999 and 1998 and contributed an additional $1,293,000 to net sales.

Gross Profit: Gross profit for 1999 increased $6,315,000, or 16.8%, to $43,975,000, which represented 25.7% of net sales, compared to $37,660,000, which represented 24.3% for 1998. This increase in gross margin percentage was primarily due to:

- Higher margins on sales made through our direct sales offices, which made significant contributions to sales of our products for the first time during the last half of 1999;

- Margin improvement from our ongoing automation projects;

- Operational efficiencies at our newest facilities in Nevada, Illinois and North Carolina, which are gradually increasing over time and should increase to the levels experienced historically at other plants during the next twelve to eighteen months; and

- Internally produced spun-glass media for our residential and commercial flat-panel furnace and air conditioning filters began in significant quantities during the fourth quarter of 1999, providing an estimated savings of approximately $100,000.

- Hurricane Floyd which caused us to close four of our plants in the eastern United States for periods ranging from 0.5 days to 5.5 days. There is an associated insurance claim whose amount has not yet been determined, which will be booked as "other income" during the period in which the amount becomes fully determined.

Operating Expenses: Operating expenses during 1999 increased $5,694,000, or 20.3% to $33,802,000, representing 19.7% of net sales, compared to $28,108,000 for 1998, which represented 18.2% of net sales. The increase in operating expenses was primarily due to the acquisitions of Eco-Air and the Tidewater group, which added approximately $5,031,000 in operating expenses. Excluding these acquisitions, operating expenses increased $663,000 from 1999 compared to 1998. This increase is primarily due to the establishment of direct sales offices during the last part of 1998 and all of 1999, which offset the increase in gross profit margin attributable to direct office operations. Other factors affecting operating expenses included decreased expenditures for new product development expenditures between 1999 and 1998, the consolidation and centralization of overhead functions, increased in outbound freight expenses related to increased sales and higher fuel costs, and increased sales commission expenses associated with increased sales.

Discontinued Operations: In December 1999, we adopted a formal plan to close Airseal West, a wholly-owned subsidiary, and sell its various assets and product lines to unrelated third parties. The date of closure was approximately April 30, 2000. All dispositions of assets are expected to be completed before December 31, 2000. The assets to be sold consist primarily of accounts receivable, inventories, manufacturing equipment, designs and other intellectual properties. The estimated net loss of the discontinued operations of approximately $2,686,000 represents approximately $1,793,000 of losses incurred during 1999 and $893,000 of estimated loss on the disposal of the assets of Airseal West (both figures net of income tax benefit). During 1998, operating losses from Airseal West were approximately $1,253,000, net of income tax benefit.

Provision for Taxes: Our income tax provision for 1999 increased $221,000, or 5.0%, to $4,671,000, from $4,450,000 for 1998, which represented 45.9% and 40.5% of earnings from continuing operations before income taxes, respectively. Our tax provision increased because of larger amounts of nondeductible expenses, primarily amortization of goodwill, and certain one-time adjustments related to estimated accrued income taxes. Our blended state and federal tax rate, excluding the effect of nondeductible expenses consisting primarily of amortization of goodwill of approximately $900,000 per year and one-time adjustments, is approximately 40.0%.

Earnings from Continuing Operations: Earnings from continuing operations for 1999 decreased $1,038,000, or 15.9%, to $5,503,000, or $0.22 per share basic ($0.21 diluted), compared to $6,541,000, or $0.26 per share basic ($0.24 diluted), for 1998. The decrease in earnings is primarily attributable to decreases in net nonoperating income (expense), consisting primarily of additional interest expense and reduced interest income, and an increase in our effective income tax rate.

EFFECTS OF INFLATION

The Company's business and operations have not been materially affected by inflation during the periods for which financial information is presented.

LIQUIDITY AND CAPITAL RESOURCES

Working capital was $13,644,000 at December 31, 2000, compared to $45,421,000 at December 31, 1999. This includes cash and cash equivalents of $1,333,000 and $824,000 at December 31, 2000 and 1999, respectively.

Trade receivables increased $4,458,000, or 15.4%, to $33,481,000 at December 31, 2000 from $29,023,000 at December 31, 1999. The increase in receivables is primarily due to increases associated with the increased volume of net sales (approximately $4,000,000) and timing differences in shipments and payments received. Our allowance for doubtful accounts receivable increased $1,291,000, or 265%, to $1,778,000 at December 31, 2000 from $487,000 at December 31, 1999. The increase in this allowance was due to a perceived increase in the number of potentially bad accounts due to the current economic downturn. We intend to vigorously pursue all collection efforts on these perceived bad accounts.

Continuing operations consumed $543,000 of cash in 2000, compared to generating $5,290,000 of cash during 1999. The difference in cash flows was primarily related to the difference in net earnings from continuing operations, partially mitigated by increases in accounts payable. Financing activities for continuing operations provided $11,216,000 of cash in 2000, compared to $5,262,000 of cash consumed during 1999 of cash, primarily from advances on our revolving credit facility and other debt financing. Investing activities for continuing operations consumed $9,659,000 of cash during 2000, compared to $11,210,000 consumed during 1999, consisting primarily of the purchase of property, plant and equipment.

On February 9, 2000, we completed the extension of our $45,000,000 revolving credit facility with SunTrust Bank, N.A. The credit facility consists of a $30,000,000 working capital facility and a $15,000,000 line of credit to support issuances of letters of credit. Outstanding balances on the working capital facility bear interest at our option, at either (a) the "prime" rate of interest publicly announced by SunTrust Bank, which was 9.5% at December 31, 2000, or (b) the "LIBOR" rate as reported by the Wall Street Journal, which was 6.7338% at December 31, 2000, plus an amount equal to 1.00% to 1.95%, depending on the ratio of total liabilities to tangible net worth. As of December 31, 2000, we had used $26,007,000 of the working capital facility and had issued $9,400,000 of letters of credit against the line of credit, leaving approximately $4 million available for future borrowings and $5.6 million available for future letters of credit. Unless this credit facility is renewed, it will expire in June 2002. At December 31, 2000, we were in violation of certain financial loan covenants. We are currently negotiating with our banks to receive a waiver for these violations. As a result of these violations, the outstanding balance on our $30 million working capital facility has been classified as short-term debt. If we are unable to get a waiver for these loan covenant violations, we may be required to repay or refinance the outstanding balance using a different bank.

As of March 1, 2000, we entered into a Loan Agreement and issued a Note to the Johnston County Industrial Facilities and Pollution Control Financing Authority and such authority issued Industrial Development Revenue Bonds for an aggregate of $4,000,000, to be used in the construction of a glass recycling facility in Johnston County, North Carolina. This new facility is expected to be completed by the end of the first quarter of 2001. The Note has a term of 15 years and bears interest at a variable rate determined by the remarketing agent of the Bonds on a weekly basis equal to the minimum rate necessary to sell such Bonds at their par value. In May 2000, we entered into an interest rate swap which is a hedge which effectively fixes the interest rate of the Bonds to a rate of 5.14% per annum. The Bonds are collateralized by a $4,000,000 letter of credit which expires in June 2002.

Continuing expansion may require substantial capital investment for the manufacture of filtration products. Although we have been able to arrange debt facilities or equity financing to date, there can be no assurance that sufficient debt financing or equity will continue to be available in the future, or that it will be available on acceptable terms. Failure to obtain sufficient capital could materially adversely impact our growth strategy.

In 1998, the Board of Directors authorized the repurchase of up to two million shares of our common stock, which repurchase was completed in September 2000. On September 22, 2000, the Board of Directors authorized the

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repurchase of up to an additional two million shares of common stock. As of April 12, 2001, approximately 221,000 shares had been repurchased under this authorization. These shares may be acquired in the open market or through negotiated transactions. These repurchases may be made from time to time, depending on market conditions, share price and other factors. These repurchases are to be used primarily to satisfy our obligations under stock option and purchase plans or any other authorized incentive plans, or for issuance pursuant to future equity financing.

Outlook

During the first quarter of 2001, we instituted force reductions to eliminate approximately 250 redundant positions and regain efficiency at several of our manufacturing plants, and anticipate an additional reduction of approximately 100 redundant positions. This force reduction is expected to save approximately $8 million annually, beginning in the first quarter of 2001. In addition, all operating facilities and departments, including corporate headquarters, will be required to reduced wages by ten percent beyond the above-described reductions in force, either through additional reductions in force or through salary and wage reductions, including senior management wage reductions of ten percent, effective April 19, 2001, until we meet our budgets for financial and operational performance, as determined by the Board of Directors.

We are currently introducing new products for the retail marketplace, our Airia indoor air cleaners and wholehouse residential air cleaning systems. In contrast to our standard retail filters, the bulk of which sell for unit prices between $0.50 and $10, these new products will sell for substantially more (between $200 and $5,000, with replacement packs ranging from $3/mo. to $15/mo). These are new products which are substantially different in features, appearance and performance from competing products, and we have no actual market data on how successful they will be, and hence have no way of estimating their impact on the financial results of the Company. Any sales of these units in significant quantities will require additional financial resources, either through equity or financing, to finance working capital requirements for production and sale of these products. For example, placement of an initial stocking order of the lowest-priced unit by a national retailer with 5,000 locations would result in new sales in excess of $15 million, with commensurate working capital requirements. At this point, we cannot estimate when or how much working capital may be required to finance these new products, and cannot be certain that contingency plans currently in place will be sufficient.

Despite the recent downturn in consumer and commercial spending for computers and other electronic devices using semiconductors, our orders for cleanroom filtration products are currently strong, with a substantial backlog for these products. However, several analysts have predicted that capital spending for new semiconductor plants will be cut back in the next six months, and that several currently planned or in progress facilities will be placed on hold or canceled. Other analysts have commented that this sector currently has much lower visibility and ability to forecast than has been the norm. Hence, we believe it is reasonably likely that current orders for filters to be placed in new semiconductor facilities may be canceled with little or no notice. While these contracts typically allow for reimbursement of expenses incurred through date of cancellation, we will not realize any profits on any canceled contracts.

We have collected data that indicates that residential filter users replace their filters, on average, approximately once per year. Manufacturers of residential furnace and air conditioning systems recommend that these filters be changed every month. A minor trend toward increased maintenance of these residential heating and cooling systems could have a positive impact on our business.

We believe there is currently a gradually increasing public awareness of the issues surrounding indoor air quality and that this trend will continue for the next several years. We also believe there is an increase in public concern regarding the effects of indoor air quality on employee productivity, as well as an increase in interest by standards-making bodies in creating specifications and techniques for detecting, defining and solving indoor air quality problems. We further believe there will be an increase in interest in our Absolute Isolation Barriers in the future because these products may be used in both semiconductor and pharmaceutical manufacturing plants to prevent cross-contamination between different lots and different processes being performed at the same facility. These products also increase production yields in many applications.

Our most common products, in terms of both unit and dollar volume, are residential throw-away spun glass filters, which usually sell for prices under $1.00. Any increase in consumer concern regarding air pollution, airborne pollens, allergens, and other residential airborne contaminants could result in replacement of some of these products with higher value products. Our higher value products include our NaturalAire higher-efficiency filters for

residential use, with associated sales prices typically over $5.00 each. Any such trend would have a beneficial effect on our business. If our residential air cleaners are successful, we believe replacement filter sales, and the increased awareness of indoor air quality engendered by the simple presence of the air cleaners, will help to create and/or accelerate this trend.

Currently, the largest domestic market for air filtration products is for mid-range ASHRAE-rated products and HVAC systems, typically used in commercial and industrial buildings. To date, our penetration of this market has been relatively small. We believe our ability to offer a "one stop" supply of air filtration products to HVAC distributors and wholesalers may increase our share of this market. We also believe that our recently developed modular air handlers and environmental tobacco smoke systems will enable us to expand sales to these customers. We intend our new products to serve as high profile entrants with distributors and manufacturers' representatives, who can then be motivated to carry our complete product line.

This Outlook section, and other portions of this document, include certain "forward-looking statements" within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, including, among others, those statements preceded by, following or including the words "believe," "expect," "intend," "anticipate" or similar expressions. These forward-looking statements are based largely on the current expectations of management and are subject to a number of assumptions, risks and uncertainties. Our actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include those discussed below under the heading "Factors That May Affect Future Results" as well as:

- the shortage of reliable market data regarding the air filtration market,

- changes in external competitive market factors or in our internal budgeting process which might impact trends in our results of operations,

- anticipated working capital or other cash requirements,

- changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the market,

- product obsolescence due to the development of new technologies, and

- various competitive factors that may prevent us from competing successfully in the marketplace.

In light of these risks and uncertainties, there can be no assurance that the events contemplated by the forward-looking statements contained in this Form 10-K will in fact occur.

Factors That May Affect Future Results

Failure to Manage Future Growth Could Adversely Impact Our Business Due to the Strain on Our Management, Financial and Other Resources

If our business continues to grow, the additional growth will place burdens on management to manage such growth while maintaining profitability. We have no guarantee that we will be able to do so. Due to our recent acquisitions and expansions, our net sales increased by approximately 405% from 1995 through 2000, (a compound annual growth rate of 32%). We may not continue to expand at this rate. Our ability to compete effectively and manage future growth depends on our ability to:

- recruit, train and manage our work force, particularly in the areas of corporate management, accounting, research and development and operations,

- manage production and inventory levels to meet product demand,

- manage and improve production quality,

- expand both the range of customers and the geographic scope of our customer base, and

- improve financial and management controls, reporting systems and procedures.

Any failure to manage growth effectively could have a material adverse effect on our business, financial condition and results of operations.

Any Delay in Procuring Financing for New Products or Failure to Adequately Ramp-Up Production Capacity to Meet Demand Could Adversely Impact Our Business Due to Strain on Financial Resources.

During 2001 we are introducing and mass marketing products which, if successful, will require large amounts of additional financing and/or capital. This financing may need to be available on short notice. Any failure to obtain such financing, or delay in financing, could cause the failure of the new products due to inability to deliver on time, and could adversely impact relationships with current major accounts. In addition, delays in an untried supply chain, new production chains, and other delays common to the launch of a new product line could also adversely impact the success of the products, as well as current relationships with major accounts.

Failure to Negotiate Appropriate Loan Covenant Waivers or Obtain Alternate Financing on Beneficial Terms Could Negatively Impact Our Business and Shareholders

As of December 31, 2000, we were in violation of certain loan covenants on our $30 million operating capital line which have not been waived. If our current and ongoing attempts to obtain waivers from our banks are unsuccessful, and we are unable to obtain alternate financing on beneficial terms, we could be forced to obtain financing or raise equity under terms which would not be favorable to us in order to continue to operate our business, which could have a significantly adverse impact on our business and operations or lead to significant dilution to our existing shareholders.

We Must Develop, Produce and Sell New Products That Keep Up With Rapid Technological Change to Maintain Approximately 15% of Our Revenues and Maintain Value of Our Inventory and Other Assets

As of December 31, 2000, approximately 15% of our revenues resulted from sales of high-end filtration products that are especially vulnerable to new technology development. Our ability to remain competitive in this area will depend in part upon our ability to:

- anticipate technological changes,
- develop new and enhanced filtration systems that meet our customers' needs, and
- introduce these systems at competitive prices in a timely and cost-efficient manner.

We have no assurance that we will successfully anticipate future technological changes or that technologies or systems developed by others will not render our technology obsolete. Additionally, we have no assurance that the products we develop will be commercially viable. A failure to successfully anticipate future technological changes could also require us to write down inventories, equipment or other assets associated with obsolete products or dispose of these assets at a price lower than book value, which could have a material adverse effect on our financial condition and results of operations.

Our Business May Suffer if Our Competitive Strategy is Not Successful

Our continued success depends on our ability to compete in an industry that is highly competitive. This competition may increase as new competitors enter the market. Several of these competitors may have longer operating histories and greater financial, marketing and other resources than we do. Additionally, our competitors may introduce new products or enhancements to products that could cause a decline in sales or loss of market acceptance of our existing products. Under our current competitive strategy, we endeavor to remain competitive by:

- increasing our market share,
- expanding our market through the introduction of new products which require periodic replacement, and
- improving operating efficiencies.

Although our executive management team continues to review and monitor our strategic plans, we have no assurance that we will be able to follow our current strategy or that this strategy will be successful.

Our Market Share May Not Continue to Increase if we are Unable to Acquire Additional Synergistic Businesses

In the past several years we have significantly increased our market share by acquiring synergistic businesses. Although we intend to continue to increase our market share in this manner, we have no assurance that future acquisition opportunities will be available. Additionally, in the future we may not have access to the substantial debt or equity financing to finance potential acquisitions. Moreover, these types of transactions may result in potentially dilutive issuances of equity securities, the incurrence of additional debt and amortization of expenses related to goodwill and intangible assets, all of which could adversely affect our profitability. Our strategy of growth through acquisition also exposes us to the potential risks inherent in assessing the value, strengths, weaknesses, and potential profitability of acquisition candidates and in integrating the operations of acquired companies. We do not currently have any binding agreements with respect to future acquisitions.

Our Business May Suffer if Our Strategy to Increase the Size and Customer Base of the Air Filtration Market is Unsuccessful

We are developing new products as part of our strategy to increase the size and customer base of the air filtration market. We have no assurance that this strategy will be successful. We have no guarantee that any new products we develop will gain acceptance in the marketplace, or that these products will be successful. Additionally, we have no assurance we will be able to recoup the expenditures associated with the development of these products. To succeed in this area we must:

- increase public awareness of the issues surrounding indoor air quality,

- adequately address the unknown requirements of the potential customer base,

- develop new products that are competitive in terms of price, performance and quality, and

- avoid significant increases in current expenditure levels in development, marketing and consumer education.

We May Experience Critical Equipment Failure Which Could Have a Material Adverse Effect on Our Business

If we experience extended periods of downtime due to the malfunction or failure of our automated production equipment, our business, financial condition and operations may suffer. We design, manufacture and assemble the majority of the automated production equipment used in our facilities. We also use other technologically advanced equipment for which manufacturers may have limited production capability or service experience. If we are unable to quickly repair our equipment or quickly obtain new equipment or parts from outside manufacturers, we could experience extended periods of downtime in the event of malfunction or equipment failure.

If Automation of Our Production Lines Fails to Produce the Projected Results, Our Business Will Suffer

We have only recently substantially completed a program to increase our gross margins by automating portions of our production lines. Although the designs have been extensively tested in the field, we have no assurance that the new equipment will produce the expected beneficial results on our gross margins. Additionally, we are not certain that any increases in efficiencies will not be offset in the marketplace by competitors making similar improvements to their facilities.

Our Plan to Centralize Overhead Functions May Not Produce the Anticipated Benefits to Our Operating Results

We are currently implementing plans to centralize and eliminate duplication of efforts between our subsidiaries in the following areas:

- purchasing,
- production planning,
- shipping coordination,
- marketing,
- accounting,
- personnel management,
- risk management, and
- benefit plan administration.

We have no assurance that cutting overhead in this fashion will have the anticipated benefits to our operating results. Additionally, we have no assurance that these reorganizations will not significantly disrupt the operations of the affected subsidiaries.

Our Success Depends on Our Ability to Retain and Attract Key Personnel

Our success and future operating results depend in part upon our ability to retain our executives and key personnel, many of whom would be difficult to replace. Our success also depends on our ability to attract highly qualified

engineering, manufacturing, technical, sales and support personnel for our operations. Competition for such personnel, particularly qualified engineers, is intense, and there can be no assurance that we will be successful in attracting or retaining such personnel. Our failure to attract or retain such persons could have a material adverse effect on our business, financial condition and results of operations.

Our Current Distribution Channels May be Unavailable if Our Manufacturers' Representatives Decide to Work Primarily With One of Our Competitors

We provide our manufacturers' representatives with the ability to offer a full product line of air filtration products to existing and new customers. Some of our competitors offer similar arrangements. We do not have exclusive relationships with most of our representatives. Consequently, if our representatives decide to work primarily with one of our competitors, our current distribution channels, and hence, our sales, could be significantly reduced.

Management Controls a Significant Percentage of Our Stock

As of April 12, 2001, our directors and executive officers beneficially held approximately 43.6% of our outstanding common stock. As a result, such shareholders effectively control or significantly influence all matters requiring shareholder approval. These matters include the election of directors and approval of significant corporate transactions. Such concentration of ownership may also have the effect of delaying or preventing a change in control.

We May be Required to Issue Stock in the Future That Will Dilute the Value of Our Existing Stock

If we issue the following securities, such securities may dilute the value of the securities that our existing stockholders now hold.

We have granted warrants to purchase of total of 540,000 of our shares of common stock to various parties with exercise prices ranging from $5.54 to $14.73 per share. All of the warrants are currently exercisable. As a result, if the warrant holders exercise these warrants, we will issue shares of stock that will generally be available for sale in the public market.

We have granted options to purchase a total of 4,718,200 shares of common stock to various parties with exercise prices ranging from $2.50 to $9.50 per share. The majority of these options are currently exercisable. Additionally, most of the common stock issuable upon the exercise of these options is registered on a Form S-8. As a result, if the option holders exercise these options, we will issue shares of stock that will generally be available for sale in the public market.

Our Shareholders May Not Realize Certain Opportunities Because of Our Charter Provisions and North Carolina Law

Our Articles of Incorporation and Bylaws contain provisions that are designed to provide our board of directors with time to consider whether a hostile takeover offer is in our best interest and the best interests of our shareholders. These provisions may discourage potential acquisition proposals and could delay or prevent a change of control in our business. Additionally, we are subject to the Control Shares Acquisition Act of the State of North Carolina. This act provides that any person who acquires "control shares" of a publicly held North Carolina corporation will not have voting rights with respect to the acquired shares unless a majority of the disinterested shareholders of the corporation vote to grant such rights. This could deprive shareholders of opportunities to realize takeover premiums for their shares or other advantages that large accumulations of stock would typically provide.

Our Business Can be Significantly Affected by Environmental Laws

The constantly changing body of environmental laws and regulations may significantly influence our business and products. These laws and regulations require that certain environmental standards be met and impose liability for the failure to comply with such standards. While we endeavor at each of our facilities to assure compliance with environmental laws and regulations, we cannot be certain that our operations or activities, or historical operations by others at our locations, will not result in civil or criminal enforcement actions or private actions that could have a materially adverse effect on our business. We have, in the past, and may, in the future, purchase or lease properties with unresolved potential violations of federal or state environmental regulations. In these transactions, we have been successful in obtaining sufficient indemnification and mitigating the impact of the issues without recognizing

significant expenses associated with litigation and cleanup. However, purchasing or leasing these properties requires us to weigh the cost of resolving these issues and the likelihood of litigation against the potential economic and business benefits of the transaction. If we fail to correctly identify, resolve and obtain indemnification against these risks, they could have a material adverse impact on our financial position.

Because of the foregoing factors, as well as other variables affecting our operating results, past financial performance should not be considered a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to various market risks, including changes in foreign currency exchange rates and interest rate risks. Market risk is the potential loss arising from adverse change in market rates and prices, such as foreign currency exchange and interest rates. For the Company, these exposures are primarily related to the sale of product to foreign customers and changes in interest rates. The Company does not have any derivatives or other financial instruments for trading or speculative purposes.

The fair value of the Company's total debt at December 31, 2000 was approximately $49,370,000. Market risk was estimated as the potential decrease (increase) in future earnings and cash flows resulting from a hypothetical 10% increase (decrease) in the Company's estimated weighted average borrowing rate at December 31, 2000. Although most of the interest on the Company's debt is indexed to a market rate, there would be no material effect on the future earnings or cash flows related to the Company's total debt for such a hypothetical change.

The Company's financial position is not materially affected by fluctuations in currencies against the U.S. dollar, since assets held outside the United States are negligible. The Company's sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency prices, as the preponderance of its foreign sales occur over short periods of time or are demarcated in U.S. dollars.

Item 8. Financial Statements and Supplementary Data

Attached, beginning at page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On November 23, 1999, the Board of Directors approved (i) the engagement of Grant Thornton LLP as the independent auditors for Flanders Corporation and (ii) the dismissal of McGladrey & Pullen LLP as such independent auditors. The shareholders ratified this selection in our annual meeting held December 21, 1999.

During the three years ended December 31, 1998 and the subsequent interim period through November 23, 1999, (i) there were no disagreements with McGladrey & Pullen, LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to its satisfaction would have caused it to make reference in connection with its report to the subject matter of the disagreement, and (ii) McGladrey & Pullen, LLP did not advise the registrant regarding any "reportable events" as defined in Item 304 (a)(1)(v) of Regulation S-K.

The accountants' report of McGladrey & Pullen, LLP on the consolidated financial statements of Flanders Corporation and subsidiaries as of and for the years ended December 31, 1998, 1997 and 1996 did not contain any adverse opinion or disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope, or accounting principles.

Neither Grant Thornton LLP or its members has any financial interest, direct or indirect in the Company nor has Grant Thornton LLP or any of its members ever been connected with the Company as a promoter, underwriter, trustee, director, officer or employee.

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PART III

Item 10. Directors and Executive Officers of the Registrant

IDENTIFICATION OF DIRECTORS AND EXECUTIVE OFFICERS

Set forth below is information regarding (i) the current directors of the Company, who will serve until the next annual meeting of shareholders or until their successors are elected or appointed and qualified, and (ii) the current executive officers of the Company, who are elected to serve at the discretion of the Board of Directors.

Name	Age	Title
Robert R. Amerson	50	President, Chief Executive Officer and Director
Linda Palmatier	47	Vice President Retail Sales
Steven K. Clark	48	Chief Operating Officer, Vice President Finance/Chief Financial Officer and Director
Knox Oakley	42	Vice President Fore-Market Sales
John Houmis	53	Vice President Engineering
Linwood Allen Hahn	52	Director
J. Russell Fleming	51	Director

Robert R. Amerson. Mr. Amerson has been President and Chief Executive Officer since 1988. Mr. Amerson is also a Director, a position he has held since 1988. He joined us in 1987 as Chief Financial Officer. Mr. Amerson has a Bachelor of Science degree in Business Administration from Atlantic Christian College.

Linda Palmatier. Ms. Palmatier, has been Vice President of Retail Sales for the Company since October 2000. From December 1998 to October 2000, Ms. Palmatier was the Company's Director of Procurement. From December 1996 through December 1998, she worked as a designer/sales representative for Com-Net Software Specialist and Signature Electronics. From August 1995 through December 1996, she worked as Director of Merchandising for J. Bill Circuit, Inc., a contract manufacturer of electronics. Ms. Palmatier holds a Bachelor of Science degree in business statistics from Virginia Commonwealth University and a Master of

Science degree in humanities from the University of Richmond..

Steven K. Clark. Mr. Clark was named as Vice President Finance, Chief Financial Officer and Director in December 1995 and Chief Operating Officer in November 1999. Mr. Clark acted as a consultant from November, 1995 through December, 1995. From July 1992 through October 1995, he was the Chief Financial Officer of Daw Technologies, Inc., a specialty cleanroom contractor and major customer of the Company. While Chief Financial Officer of Daw Technologies, Mr. Clark was late in filing a Form 3 amendment and certain Form 4s and Form 5s. He agreed to a cease and desist order with respect to these violations. No violations other than the timeliness of filing those reports were alleged by the Securities and Exchange Commission ("SEC"). Prior to this he was a senior partner of Miller and Clark, an accounting and management services firm. Mr. Clark spent four years with Price Waterhouse, and an additional four years with Arthur Andersen, both accounting firms. He is a Certified Public Accountant, has Bachelor of Arts degrees in Accounting and Political Science and a Master of Business Administration Degree, all from the University of Utah.

Knox Oakley. Mr. Oakleyhas been Vice President of Fore-Market Sales since October 2000 and Vice President of Sales for Flanders Filters, Inc., a subsidiary of the Company, since June 1994. Mr. Oakley received his Bachelor of Science degree in biology from the Citadel.

John Houmis. Mr. Houmis has been Vice President Engineering since December 1998. He has direct responsibility for manufacturing engineering, quality control and production control systems. From May 1998 to December 1998, he was Director of Special Project - Plants for Precisionaire, a wholly owned subsidiary. From 1993 to October 1997, Mr. Houmis was the general manager of Precisionaire's main manufacturing facility in Florida. Mr. Houmis has Bachelor of Science and Master of Science degrees in engineering from the University of South Florida.

Linwood Allen Hahn. Mr. Hahn was elected as a Director in December 1999. Mr. Hahn practices Real Property Law, Estates, Municipal Law and Corporate Law in Greenville, North Carolina. Mr. Hahn graduated from he University of North Carolina at Chapel Hill with a BA degree in 1970, the University of Tennessee College of Law, JD degree in 1973. He is currently a member of the North Carolina State Bar Association and the North Carolina Trial Lawyer's Association as well as serving on the advisory boards of several private charitable organizations.

J. Russell Fleming. Mr. Fleming was elected as a Director in December 1999. Mr. Fleming is Owner/President of Cape Point Development Co., Inc., located in Greenville, North Carolina, specializing in land development and commercial/multi-family construction. Mr. Fleming is also Owner/President of New East Management & Realty, Inc., also located in Greenville, NC, which manages residential and commercial rental properties. Mr. Fleming attended East Carolina University prior to obtaining his General Contractor and Real Estate Broker licenses.

Item 11. Executive Compensation

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee of the Company's Board of Directors consists of Messrs. Hahn and Fleming, both non-employee directors, and Messr. Amerson, the

Chief Executive Officer. The Audit Committee of the Company's Board of Directors consists of Messrs. Hahn and Fleming, both non-employee directors, and Messr. Clark, the Chief Financial Officer, who chairs the committee.

SUMMARY COMPENSATION TABLE

The following table sets forth the aggregate cash compensation paid by the Company for services rendered during the last three years to the Company's Chief Executive Officer and to each of the Company's other executive officers whose annual salary, bonus and other compensation exceeded $100,000 in 2000.

		Annual Compensation			Long-Ter
					Award
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compen- sation ($)	Restricted Stock Award(s) ($)
Robert R. Amerson	2000(1)	250,000	-	-	-
President and CEO	1999	254,808	-	-	-
	1998	250,000	-	-	-
Steven K. Clark	2000(1)	250,000	-	-	-
Vice President Finance/CFO	1999	250,000	-	-	-
	1998	250,000	-	-	-
John Houmis	2000	100,719	-	-	-
Vice President Engineering	1999	106,164	-	-	-
	1998(3)	59,828	-	-	-

1 Mr. Amerson and Mr. Clark each had an annual salary of $250,000, plus a possible bonus each year, under their respective Employment Agreements, as amended. Subsequent to year end, these salaries were reduced by ten percent, to $225,000 per year. See "Employment Agreements."

2 Messrs. Amerson and Clark each had options to purchase 1,000,000 shares at $2.50 per share whose expiration date was extended, on December 22, 1999, from February 22, 2001 to February 22, 2006. This extension resulted in the establishment of a new measurement date for the value of the options for financial statement reporting purposes. On the date of grant, the closing market price for the Company's stock was equal to or above the options' strike price.

3 Mr. Houmis' compensation for 1998 reflects seven months' salary.

AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR-END OPTION/SAR VALUES

The following table sets forth the aggregate number and value of stock options and SAR's exercised during the last year by the Company's Chief Executive Officer and by each of the Company's other executive officers whose annual salary, bonus and other compensation exceed $100,000.

Name	Shares Acquired On Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at Fiscal Year-End (#) Exercisable/Unexercisable	Value of Unexerc In-the-Money Opti SARs at Fiscal Yea Exercisable/Unexerc
Robert R. Amerson	1,150,000	$ 431,250	2,000,000 / -	- / -
Steven K. Clark	1,150,000	$ 431,250	2,000,000 / -	- / -
John Houmis	-	-	- / -	- / -

COMPENSATION OF DIRECTORS

Directors who are Company employees receive no additional or special remuneration for serving as directors. The Company's non-employee Directors are paid $500 plus out-of-pocket expenses for each meeting of the Board of Directors and after being a Director for at least six months receive an automatic option to purchase 5,000 shares of the Company's common stock on January 1 of every year at or above the market price of the common stock on the date of grant for every year they remain a director. During 1999, each of the non-employee directors received an option to purchase 50,000 shares of the Company's common stock at an exercise price of $2.50 per share.

EMPLOYMENT AGREEMENTS

Messrs. Amerson and Clark have employment agreements effective as of December 15, 1995 ("Employment Agreements"). The Employment Agreements, as amended, provide for an annual base salary of $250,000 for both Mr. Amerson and Mr. Clark and terminate in 2010. The Employment Agreements also provide that the executive shall be entitled to the following termination payments: (i) 100% of his current base salary if the employment is terminated as a result of his death or disability; (ii) up to 200% of his current base salary if the employment is terminated by the Company for any reason other than death, disability or for cause, or (iii) up to 250% of the executive's gross income during the year preceding his termination if the Employment Agreement is terminated by the executive for good reason or by the Company for any reason other than death, disability or cause and the termination occurs within two years after a change of control of the Company has occurred.

OTHER INFORMATION REGARDING THE BOARD OF DIRECTORS

Board Meetings and Committees

During 2000, the Board of Directors met four times and also executed various resolutions and written actions in lieu of meetings. All directors were in attendance at each of these meetings. The Board of Directors has an Audit Committee and a Compensation Committee. The Audit Committee reviews the results and scope of the audit and other services provided by the Company's independent auditors, reviews and evaluates the Company's internal audit and control functions, and monitors transactions between the Company and its employees, officers and directors. The Compensation Committee administers the Company's equity incentive plans and designates compensation levels for officers and directors of the Company. The Audit Committee met four times during 2000. The Compensation Committee met two times during 2000.

Currently, the Audit Committee consists of Messrs. Hahn, Fleming and Clark. The Compensation Committee consists of Messrs. Hahn, Fleming and Amerson.

Long-Term Incentive Plan

During 1996, the Company adopted the Long Term Incentive Plan to assist the Company in securing and retaining key employees and consultants. The LTI Plan authorizes grants of incentive stock options, nonqualified stock options, stock appreciation rights ("SARs"), restricted stock performance shares and dividend equivalents to officers and key employees of the Company and outside consultants to the Company. There are 1,986,800 shares of Common Stock reserved for award under the LTI Plan. During 2000, 1999 and 1998, the Company awarded options to purchase 12,500, 52,850 and 216,850 shares of Common Stock under the LTI Plan, respectively.

The Plan is administered by the Compensation Committee. The Compensation Committee determines the total number and type of awards granted in any year, the number and selection of employees or consultants to receive awards, the number and type of awards granted to each grantee and the other terms and provisions of the awards, subject to the limitations set forth in the LTI Plan.

Stock Option Grants. The Compensation Committee has the authority to select individuals who are to receive options under the LTI Plan and to specify the terms and conditions of each option so granted (incentive or nonqualified), the exercise price (which must be at least equal to the fair market value of the common stock on the date of grant with respect to incentive stock options), the vesting provisions and the option term. Unless otherwise provided by the Compensation Committee, any option granted under the LTI Plan expires the earlier of ten years from the date of grant or, three months after the optionee's termination of service with the Company if the termination of employment is attributable to (i) disability, (ii) retirement, or (iii) any other reason, or 15 months after the optionee's death. As of April 12, 2001, there are 598,680 options outstanding under the LTI Plan.

Stock Appreciation Rights. The Compensation Committee may grant SARs separately or in tandem with a stock option award. A SAR is an incentive award that permits the holder to receive (per share covered thereby) an equal amount by which the fair market value of a share of common stock on the date of exercise exceeds the fair market value of such share on the date the SAR was granted. Under the LTI Plan, the Company may pay such amount in cash, in common stock or a combination of both. Unless otherwise provided by the Compensation Committee at the time of grant, the provisions of the LTI Plan relating to the termination of employment of a holder of a stock option will apply equally, to the extent applicable, to the holder of a SAR. A SAR granted in tandem with a related option will generally have the same terms and provisions as the related option with respect to exercisability. A SAR granted separately will have such terms as the Compensation Committee may determine, subject to the provisions of the LTI Plan. As of April 12, 2001, no SARs are outstanding under the LTI Plan.

Performance Shares. The Compensation Committee is authorized under the LTI Plan to grant performance shares to selected employees. Performance shares are rights granted to employees to receive cash, stock, or other property, the payment of which is contingent upon achieving certain performance goals established by the Compensation Committee. As of April 12, 2001, no performance shares are outstanding under the LTI Plan.

Restricted Stock Awards. The Compensation Committee is authorized under the LTI Plan to issue shares of restricted common stock eligible participants on such terms and conditions and subject to such restrictions, if any, outstanding under the LTI Plan. As of April 12, 2001, no restricted shares have been awarded under the LTI Plan.

Dividend Equivalents. The Compensation Committee may also grant dividend equivalent rights to participants subject to such terms and conditions as may be selected by the Compensation Committee. Dividend equivalent rights entitle the holder to receive payments equal to dividends with respect to all or a portion of the number of shares of stock subject to an option award or SARs, as determined by the Committee. As of April 12, 2001, no dividend equivalents are outstanding under the LTI Plan.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth all individuals known by the Company to beneficially own 5% or more of the Company's common stock, and all officers and directors of the registrant, with the amount and percentage of stock beneficially owned, as of April 12, 2001. Except as indicated in the following footnotes, each listed beneficial owner has sole voting and investment power over the shares of common stock held in their names.

Name and Address of Beneficial Owner	Shares of Common Stock Beneficially Owned	Percentage of Outstanding Shares of Common Stock(1)
Robert R. Amerson(2) 531 Flanders Filters Road Washington, NC 27889	7,914,370	27.89%
Linda Palmatier 2399 26th Avenue North St. Petersburg, FL 33713	-	*
Steven K. Clark(2) 2399 26th Avenue North St. Petersburg, FL 33713	5,170,183	18.22%
Knox Oakley(3) 531 Flanders Filters Road Washington, NC 27889	82,725	*
John Houmis 2399 26th Avenue North St. Petersburg, FL 33713	-	*
Linwood Allen Hahn(4) 531 Flanders Filters Road Washington, NC 27889	52,500	*

J. Russell Fleming(4) 531 Flanders Filters Road Washington, NC 27889	70,000	*
Thomas T. Allan 3114 Barracks Road Charlottesville, VA 22901	1,590,232	6.03%
Franklin Resources, Inc. 777 Marivers Island Blvd., 6th Fl. San mateo, CA 94404	1,390,286	5.27%
Dimensional Fund Advisors, Inc. 1299 Ocean Avenue, 11th Floor Santa Monica, CA 90401	2,094,700	7.94%
Becker Capital Management, Inc. 1211 SW Fifth Avenue, Suite 2185 Portland, OR 97204	1,886,900	7.15%
All Executive Officers and Directors as a Group (8 persons)(2)(3)(4)	13,289,778	43.57%

* Represents less than 1% of the total issued and outstanding shares of common stock.

1 Applicable percentage of ownership is based on 26,379,633 shares of common stock outstanding as of April 12, 2001, together with all applicable options for unissued securities for such shareholders exercisable within sixty days. Shares of common stock subject to options exercisable within sixty days are deemed outstanding for computing the percentage ownership of the person holding such options, but are not deemed outstanding for computing the percentage of any other person.

2 Includes 1,000,000 shares which are subject to an option to purchase such shares from the Company at $2.50 per share and 1,000,000 shares which are subject to an option to purchase such shares from the Company at $7.50 per share.

3 Includes 10,000 shares which are subject to an option to purchase such shares from the Company at $7.50 per share, and 10,000 shares which are subject to an option to purchase such shares from the Company at $7.125 per share.

4 Includes 50,000 shares which are subject to an option to purchase such shares from the Company at $2.50 per share.

Item 13. Certain Relationships and Related Transactions

At December 31, 2000, Steven K. Clark owed the Company $3,836,169 of principal and $224,231 of accrued interest which he previously borrowed to settle claims, to make certain payments under an indemnity agreement he entered into with the Company, to exercise options and to purchase certain shares from Thomas T.

Allan, a former officer and director. On April 24, 1999, the Board of Directors agreed to consolidate several then existing notes from Mr. Clark and refinance Mr. Clark's debts to the Company, whereby Mr. Clark issued a note to the Company in the amount of $2,569,871 with interest accruing at the rate of LIBOR plus 1%, payable in full on December 31, 2010 or upon demand by the Company. On November 15, 2000, the Board of Directors agreed to finance the exercise of Mr. Clark's options, whereby Mr. Clark issued a note to the Company in the amount of $1,150,000 with interest accruing at the rate of LIBOR plus 1%, payable in full on December 31, 2010 o